DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0221
Indiana Corporation Income Tax
For Years 1989 to 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Property Tax Addback to Determine Taxpayer's Adjusted Gross Income: Property Taxes Paid by Taxpayer Lessor.

Authority: IC 6-3-1-3.5(b); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-8; 45 IAC 3.1-1-8(3)(b); I.R.C. § 63; I.R.C. § 164.

The taxpayer has protested the auditor's determination that property taxes, levied by local taxing jurisdictions on the taxpayer's leased property and paid by the taxpayer as lessor, should be added back in the calculation of the taxpayer's Indiana adjusted gross income tax.

II. Calculation of Property Tax Addback: Inclusion of Lessee Rendered Taxes.

Authority: 45 IAC 3.1-1-8(3)(b); I.R.C. § 61; I.R.C. § 63; I.R.C. § 164.

Taxpayer has protested the auditor's determination that property taxes, the responsibility for which had been assumed by the lessee, should be included within the property tax addback calculation used to determine taxpayer's Indiana adjusted gross income tax.

III. Gross Income Tax Reporting: Taxpayer's Indiana Nexus.

Authority: Indiana Dept. of Revenue v. Bethlehem Steel, 639 N.E.2d 264 (Ind. 1994); 45 IAC 1-1-49; 45 IAC 1-1-51.

The taxpayer has protested the auditor's determination that receipts derived from the lease of certain equipment located within Indiana should be included as a part of the taxpayer's gross income. In support of that proposition, taxpayer maintains that it has neither a "business situs" or a "commercial domicile" within the state.

IV. Gross Income Assessed at High Rate: Sales of Previously Leased Equipment.

Authority: IC 6-2.1-2-3; IC 6-2.1-2-4; IC 6-2.1-2-4(1); IC 6-2.1-2-4(4); IC 6-8.1-5-1(b).

The taxpayer has protested the auditor's determination that receipts from sales of certain equipment, previously leased by the taxpayer, should be taxed at the higher rate. Taxpayer argues that the sales of previously leased equipment are a regular part of the taxpayer's business, occurring in the regular course of the taxpayer's business, and should be taxed at the lower rate.

STATEMENT OF FACTS

Taxpayer is an out-of-state entity in the business of leasing aircraft and certain types of other commercial equipment. Taxpayer has no representatives within the state. Taxpayer maintains no physical location within Indiana but has conducted its leasing activities within the state.

DISCUSSION

I. Property Tax Addback to Determine Taxpayer's Adjusted Gross Income: Property Taxes Paid by Taxpayer Lessor.

For some of the taxpayer's leased equipment, the taxpayer – as lessor – bills and collects property taxes from the individual lessees. According to taxpayer, this is a common practice within the leasing industry. Because the property tax payments and the reimbursements received from the lessees "net" to zero, the taxpayer argues that the property tax reimbursements should not be added back in determining its taxable adjusted gross income.

IC 6-3-1-3.5(b) provides the starting point for determining taxpayer's taxable income stating that the term "adjusted gross income" shall mean, "In the case of corporations the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code . . . ." The Department's Administrative Rules restates the basic principle at 45 IAC 3.1-1-8 stating that "'Adjusted Gross Income' with respect to corporate taxpayers is 'taxable income' as defined in Internal Revenue Code – section 63 . . . ." In Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996), the court held that the code provision was "plain and unambiguous." Id. at 1213. "Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 63, not as reported by the taxpayer." Id.

In calculating the taxpayer's adjusted gross income, Indiana begins with the federal definition as found in I.R.C. § 63. However, in calculating federal adjusted gross income, I.R.C § 164, allows for a deduction of property taxes stating that "[e]xcept as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accured: (1) State and local, and foreign real property taxes. (2) State and local personal property taxes."

After determining the taxpayer's federal adjusted gross income, Indiana's own regulations provide for particular adjustments to that amount, one of which is relevant here. 45 IAC 3.1-1-8(3)(b) provides for the addback of "[p]roperty taxes levied by a political subdivision of any state . . . ." The effect of the regulatory provision is to subject property taxes, even if otherwise not subject to the federal adjusted gross income tax, to the state's own adjusted gross income tax scheme.

Taxpayer's receipt of payments from its lessees – designated and segregated as property tax reimbursements – falls within the IC 6-3-1-3.5(b) definition of "Adjusted gross income." Taxpayer is entitled to the federal property tax deduction and, subsequently, Indiana is both entitled and authorized to add that same deduction back for purposes of calculating taxpayer's Indiana adjusted gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Property Tax Addback to Determine Taxpayer's Adjusted Gross Income: Property Taxes Paid by Lessee on Behalf of Taxpayer Lessor.

The terms of the lease agreements between certain of the lessees and the taxpayer require that the individual lessees assume responsibility for paying property taxes levied against the leased equipment. In those instances, the lessees and the taxpayer have agreed that the individual lessees will be solely responsible for paying any applicable property taxes. The audit included these property tax payments in calculating the property tax addback. Taxpayer now argues that these amounts should not be included in the addback.

As set out in Section I, Indiana is entitled to add back property taxes for the purpose of determining the taxpayer's adjusted gross income tax. Taxpayer argues that, by shifting the responsibility for property taxes levied against the leased property to the various lessees, taxpayer is entitled to avoid liability for paying Indiana income taxes on those amounts.

Taxpayer is entitled to structure its lease agreements in any manner which it deems appropriate. Taxpayer is entitled to require the lessees to assume the immediate responsibility for property taxes levied against the leased property. Indeed, taxpayer is entitled to require the lessees to direct the lease payments in any manner it chooses and to designate those payments in any manner it chooses. However, the property taxes are levied against the taxpayer's own property, are simply one portion of the "cost" that the lessees assume when entering into the agreements, and are ultimately the taxpayer's own responsibility.

Taxpayer has provided nothing upon which to refute the presumption that the property tax payments, made on behalf of taxpayer by the various lessees, are not part of the taxpayer's gross income, as defined under I.R.C. § 61. That section states that taxpayer's gross income means "all income from whatever source derived, including (but not limited

to) . . . . [g]ross income derived from business." In determining its adjusted gross income under I.R.C. § 63, taxpayer is plainly entitled to deduct those property tax payments under I.R.C. § 164. Just as plainly, Indiana is entitled to require taxpayer to add back those amounts as required under 45 IAC 3.1-1-8(3)(b).

FINDING

Taxpayer's protest is respectfully denied.

III. Gross Income Tax Reporting: Taxpayer's Indiana Nexus.

Taxpayer argues that it is not subject to the state's gross income tax based upon the two tests provided within 45 IAC 1-1-51. Taxpayer maintains that, pursuant to 45 IAC 1-1-51, it has neither a "business situs" or a "commercial domicile" within the state. However, the two tests cited by taxpayer are prerequisites necessary for determining the taxability of income derived from intangibles. As stated within the regulation, "The term 'intangible' or 'intangible property,' . . . means and includes notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, 'trading stamps,' final judgments, leases, royalties, certificates of sale, choses in action and any and all other evidences of similar rights capable of being transferred, acquired or sold."

Equally unavailing is taxpayer's citation to Indiana Dept. of Revenue v. Bethlehem Steel, 639 N.E.2d 264 (Ind. 1994) as authority for the proposition that income – derived from taxpayer's leasing activities – falls outside the state's taxing jurisdiction. The issue before the court in Bethlehem Steel was whether appellee taxpayer's income, derived from the sale of certain tax benefits, was subject to Indiana's gross income tax. Id. at 265. Although the dispositive issue was whether appellee taxpayer had acquired the requisite business situs or commercial domicile within the state, that question only became dispositive because appellee taxpayer obtained income from the sale of intangibles as defined under 45 IAC 1-1-51.

Because taxpayer is in the business of leasing aircraft and other types of commercial equipment, it is more pertinent to cite to 45 IAC 1-1-49 which states in relevant part, "For purposes of these regulations [45 IAC 1-1], a taxpayer may establish a "business situs" in ways including, but not limited to, the following . . . (6) Ownership, leasing, rental or other operation of income-producing property (real or personal) . . . ."

Taxpayer's attenuated argument notwithstanding, taxpayer entered into agreements with various Indiana entities for the lease of various mobile and non-mobile equipment. Having done so, taxpayer falls squarely under the provisions of 45 IAC 1-1-49.

FINDING

Taxpayer's protest is denied.

IV. Gross Income Assessed at High Rate: Sales of Previously Leased Equipment.

Taxpayer argues that the proceeds received from the sales of previously leased equipment should not be subject to the gross income tax at the high rate.

IC 6-2.1-2-3 sets out two different rates under the state's gross income tax scheme. The statute specifies as follows:

> (a) The receipt of gross income from transactions described in section 4 of this chapter is subject to a tax rate of three-tenths of one percent (0.3%).
>
> (b) The receipt of gross income from transactions described in section 5 of this chapter is subject to a tax rate of one and two-tenths percent (1.2%).

Therefore, having determined that the income taxpayer received from conducting leasing activities within the state is subject to its gross income tax, the issue becomes whether income received from selling the previously leased equipment is subject to the low or high rate.

In order for the income to be taxed at the low rate, taxpayer's sales income must come within one of the categories set out in IC 6-2.1-2-4. The statute specifies as follows:

> The receipt of gross income from the following is subject to the rate of tax prescribed in section 3(a) of this chapter:
>
> (1) wholesale sales;
>
> (2) display advertising, including outdoor painted and poster display advertising and radio and television media advertising, but not including any sale or rental of tangible property or any personal professional service rendered in connection with such advertising;
>
> (3) the business of dry cleaning and laundering, excluding the operation of coin operated laundry and dry cleaning equipment;
>
> (4) selling at retail;
>
> (5) the business of softening and conditioning water, including the exchange of water softening and conditioning tanks in the ordinary course of business, but not including the preparation of customer's plumbing and other work incident to furnishing such tanks in the first instance;
>
> (6) the renting or furnishing for periods of less than thirty (30) days any rooms, lodgings, or any other accommodations, including booths, display spaces, and banquet facilities that are located in a place where rooms,

> lodgings, or any other accommodations are regularly furnished for a consideration; and
>
> (7) the business of commercial printing that results in printed materials, excluding the business of photocopying.

Taxpayer has provided no suggestion as to which of the particularized seven IC 6-2.1-2-4 categories the sales income should fall. The only rational categories are found at IC 6-2.1-2-4(1), "wholesale sales," and IC 6-2.1-2-4(4), "selling at retail." However, taxpayer has provided no basis to establish that the money received from the sale of previously leased equipment was derived from either "wholesale sales" or "selling at retail."

Left with no basis upon which to discern the basis for taxpayer's argument, that argument fails. Under IC 6-8.1-5-1(b), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Absent any indication that the income derived from the sale of previously leased equipment is not subject to the high rate set out in IC 6-2.1-2-5, taxpayer's invitation to reclassify that income must be declined.

FINDING

Taxpayer's protest is respectfully denied.

DK/JM/MR – 022006